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# In the Supreme Court of the United States

OCTOBER TERM, 1959

No. 641

DAVID LASH, Treasurer, David's, Inc.,
PETITIONER,

*v.*

LAURENCE A. NIGHOSIAN,
Revenue Agent,
Internal Revenue Service,
RESPONDENT.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

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LAURENCE A. NIGHOSIAN,
Revenue Agent,
Internal Revenue Service,
RESPONDENT.

## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the First Circuit, entered in the above-entitled case on December 4, 1959.

### Citation To Opinions Below

The opinion of the United States District Court for the District of Massachusetts, printed at pp. 287-293 of the

Record Appendix,[1] is reported at 171 F. Supp. 121. The opinion of the Court of Appeals of December 4, 1959 (R. 299-306)[2] is not as yet officially reported. It is printed in Appendix B (pp. 15-22, *infra*).

## Jurisdiction

The judgment of the Circuit Court of Appeals was entered on December 4, 1959 (R. 307).[3] The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

## Questions Presented

I. Section 7602 of the Internal Revenue Code of 1954 gives the Secretary or his delegate power to summon a person liable for tax "for the purpose of ascertaining the correctness of any return." The question arising under this statute is—

Where the real purpose is to investigate the conduct of Internal Revenue Service employees, does this section authorize the issuance of a summons to a taxpayer for the subsidiary purpose of ascertaining the correctness of the taxpayer's returns because the taxpayer had some social and business contacts with the employees whose conduct is being investigated?

II. Section 6501 of the Internal Revenue Code of 1954 provides that the amount of any Internal Revenue Tax shall be assessed within three years after the return was filed, except that in the case of a false or fraudulent re-

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[1] Reference is to all copies of Record Appendix in the court below filed with this petition.

[2] Reference is to the Certified Copy of the Record Appendix and Proceedings which contains the record of the judgment of the Court of Appeals. Unless otherwise indicated all other references are to all copies of the Record Appendix in the court below filed with this petition.

turn with intent to evade tax, the tax may be assessed at any time.

Section 7605(b) of the Internal Revenue Code of 1954 forbids unnecessary examination or investigations of any taxpayer.

The question raised under these provisions by the instant case is—

What degree of proof must be presented to the court by the Government to show that a re-examination or investigation of a taxpayer's return is necessary

(a) in years "closed" by the statute of limitations (§ 6501)

(b) in an open year (§ 7605(b))

where the Secretary or his delegate seeks to enforce a summons issued under section 7602.

## Statutes Involved

The statutes involved are sections 6501(a), (e)(1) and (2), 7602, 7604(b) and 7605(b) of the Internal Revenue Code of 1954, 26 U.S.C. §§ 6501(a), (e) (1) and (2), 7602, 7604(b) and 7605(b). These provisions are printed in Appendix A (pp. 12-14, *infra*).

## Statement of the Case

On May 20, 1958, petitioner was notified by Donald W. Bacon, Regional Commissioner of the Internal Revenue Service for the Boston Region, that an additional inspection of the records of David's, Inc. for the years 1952 to 1955 was necessary (Ex. 1, R. 254). These books and records had already been examined by agents of the Internal Revenue Service.

When petitioner did not produce the requested records in response to the Commissioner's letter, acting on instructions, Revenue Agent David Evans issued a summons to the petitioner under 26 U.S.C. § 7602 (R. 4-5, 20-1, 43-5, 51-2, 139-40). Petitioner and his attorney, in compliance with the summons, appeared before Revenue Agent Evans on June 24, 1958, in Fall River at the place indicated (R. 37). They brought with them all the books and records summoned with the exception of those too voluminous to transport. Petitioner's attorney read a statement to Agent Evans and gave the reasons why the petitioner believed the summons was improper. The taxpayer, however, offered to furnish voluntarily any and all information and records relating to transactions between the petitioner and Internal Revenue Service employees or former employees, but not in response to the summons (R. 38-42).

Revenue Agent Evans filed a Petition for Attachment as for Contempt under 26 U.S.C. § 7604(b) and on August 26, 1958 the District Court issued an Order to David Lash to Show Cause why his person should not be attached as for contempt (R. 2-3, 6). After hearing the District Court entered an order compelling petitioner to comply with the summons (R. 287, 293).

The Circuit Court of Appeals affirmed the judgment of the District Court (pp. 15-22, *infra*).

Commissioner Bacon's request for a re-examination of petitioner's records arose out of what was called "Boston Special Project No. 1" set up by the Internal Revenue Service to investigate malfeasance by Internal Revenue Service employees (R. 107, 216, 218).[3] This "Special Project" was directed by the branch of the Internal Revenue Service that is concerned with employee misconduct, the Inspection Service (R. 33, 51). In the course of this

[3] Cf. opinion of the District Court (R. 288).

project it was decided to interview and to re-examine the returns of taxpayers whose returns had been audited by the agents under investigation (R. 32, 47, 114-5).

The purpose of these investigations of taxpayers was to determine malfeasance by Internal Revenue Service employees and to obtain evidence in aid of possible prosecution of these employees (R. 114-5, 118). Two of the agents being investigated were Revenue Agents Alfred Larrivee and David Robbins (R. 114). Agent Larrivee audited the returns of David's, Inc. for the years 1952 and 1953; Agent Robbins audited those for 1954 and 1955 (R. 208, 214).

The investigation of the petitioner was conducted by Inspectors O'Brien, Lockwood and Bright of the Office of the Regional Inspector, Boston Region (R. 80, 240-1, 203). These Inspectors made various visits to petitioner's offices in Fall River and interrogated petitioner David Lash, the bookkeeper, Miss Boucher, and on one occasion Inspector Bright interrogated Mr. Lash's son in Providence (R. 89, 147, 188, 241, 243, 203-4).

The Inspectors, on these various occasions, asked questions solely related to business and social relationships between Agents Larrivee and Robbins and the petitioner (R. 80-8, 147-57, 188-92, 203-6). The information obtained by these Inspectors in their investigation was reported to the Regional Inspector, Emanuel M. Schuster (R. 159, 169). On the basis of this information, *Regional Inspector Schuster* decided that a re-examination of petitioner's books would be necessary in order to determine whether, in fact, Agents Larrivee and Robbins were guilty of malfeasance (R. 230).

However, petitioner's attorney had previously sent to Regional Inspector Schuster and Commissioner Bacon a letter, in connection with another matter, containing a memorandum of law denying the right of the Office of

the Regional Inspector to examine the books and records of a taxpayer for the purpose of investigating malfeasance of Internal Revenue Service employees (R. 109-10, 221-2).

Following the receipt of that letter Schuster had a conference with the United States Attorney's Office concerning the examination of taxpayer's records (R. 221-2). Subsequently, on May 8, 1959 Regional Inspector Schuster sent Regional Commissioner Bacon a memorandum summarizing the information reported by the Inspectors investigating Agents Larrivee and Robbins and requesting *Commissioner Bacon* to order a re-examination of the tax returns of David's, Inc. for the years 1952 to 1955, i.e. the returns audited by Agents Larrivee and Robbins (Ex. A, R. 266, 227-30).

This memorandum dealt solely with the conduct of Agents Larrivee and Robbins and their relationship to the petitioner. It contained no mention whatsoever of any matter related to petitioner's tax liability, such as unreported income or improper deductions by petitioner in the years in question (Ex. A, R. 266). It was admitted by the United States Attorney at trial that the Government does not know of any unreported income or improper deductions by the petitioner in the years in question and the record is replete with such admissions by the members of the Internal Revenue Service (R. 67-8, 43, 135-8, 176-7).

*Commissioner Bacon* then issued the "reopening" letter to the petitioner on May 20, 1958 (Ex. 1, R. 254, 120-1).

The District Court in denying petitioner's motions to dismiss the petition and quash the summons (R. 8-10, 58-62, 67, 95, 99-104), and the Circuit Court in affirming, rejected the petitioner's contentions that

> (a) a summons cannot properly issue under section 7602 unless it is issued primarily for a statutory purpose, and

(b) that the existence of probable cause to believe a taxpayer guilty of fraud is for the District Court to determine.

Each court instead adopted the Government's theories that

(1) as long as *one* of the purposes of the summons is to "ascertain the correctness of any return" the summons is proper, and

(2) as long as the facts upon which the *Regional Commissioner* relied constitute probable cause to believe the taxpayer guilty of fraud, then the District Court is not to substitute its judgment as to the credibility of those facts unless they are so incredible that no reasonable man could believe them.

## Reasons for Granting the Writ

1. The power to summon a taxpayer and the attendant punishment for contempt is a powerful weapon. Section 7602 grants this extraordinary power for specific limited purposes. The effect of the decision below is to empower the Secretary or his delegate to use this power for a purpose other than that set forth in the statute. The intent of Congress to protect the taxpayer against unnecessary examinations, i.e. unnecessary harassment by the taxing authorities, is evident in section 7605(b) and in the three year statute of limitations of section 6501.

The power granted by sections 7602 and 7604(b) is a source of potential harassment, even persecution, of taxpayers. The Internal Revenue Service was not given the summoning power to investigate any and every subject in which it is legitimately interested. The power to sum-

mon was granted for specific purposes, all relating to a taxpayer's liability for a tax and this power may not be used for any other purpose. It is an unwarranted extension of the power of the taxing authorities to rule that although the primary aim of a summons is not within the statute, if it also has a statutory purpose, however subsidiary, the summons is valid.

It is imperative for the protection of the individual citizen that this extraordinary power be used only within the limits and for the purposes intended by Congress.

2. The Internal Revenue Code of 1954 clearly establishes a three year limitation on the assessment of any tax except in the case of a false or fraudulent return (§ 6501(a) and (c)). The Code also forbids unnecessary re-examination of taxpayers' books (§ 7605(b)). However, the statute fails to establish any standard whatsoever for the re-examination of books relating to years which are "closed" by section 6501.

The District Courts have set up their own standards and are in conflict. Even the standards set up have resulted in countless nuances of interpretation. The District Court in the instant case "encountered difficulty in applying the rule of *O'Connor* v. *O'Connell*", 253 F. 2d 365 (1 Cir. 1958), the leading case in this Circuit (p. 21, *infra*).[4]

The following are the conflicting criteria enunciated by different Circuits for enforcement of a summons issued to a taxpayer or a third party under section 7602 for the production of books and records relating to "closed years." The Fifth Circuit has taken the position that an affidavit by an Internal Revenue Agent alleging that he suspects

[4] Cf. opinion of the District Court at R. 289. The District Court also stated at the trial that it was not in agreement with Judge Wyzanski's ruling in *United States* v. *O'Connor*, 118 F. Supp. 248 (D. Mass. 1953) on the closely related question of the permissible purposes of a summons (R. 111).

the taxpayer of fraud is sufficient.[5] *Globe Construction Co. v. Humphrey*, 229 F. 2d 148 (5 Cir. 1956).

The Sixth Circuit has recently ruled that reasonable grounds for suspecting fraud may be shown through the testimony of an Internal Revenue Agent and the taxpayer may not introduce evidence in rebuttal. *Corbin Deposit Bank of Corbin, Ky. v. United States*, 244 F. 2d 177 (6 Cir. 1956).[6]

The Third and the Ninth Circuits have taken the view that the Internal Revenue Service must show it has probable cause or reasonable grounds to believe the taxpayer guilty of fraud in the years in question. *Zimmerman v. Wilson*, 81 F.2d 847 (3 Cir. 1936), *retried* 25 F. Supp. 75 (E.D. Pa. 1938), *modified* 105 F. 2d 583 (3 Cir. 1939); *Martin v. Chandis Securities Co.*, 128 F. 2d 731 (9 Cir. 1942); *Boren v. Tucker*, 239 F. 2d 767 (9 Cir. 1956). This was also the view of the First Circuit in *O'Connor v. O'Connell*, supra.[7]

The only ruling by the Court of Appeals of the Second Circuit on this question stated that the Internal Revenue Service should not "be required to prove the grounds of its belief prior to examination . . ." *United States v.*

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[5] See also *Falsone v. United States*, 205 F.2d 734 (5 Cir. 1953), *cert. denied* 346 U.S. 864 (1953), holding that the Internal Revenue Service may examine a taxpayer's books for closed years in order to establish a sound starting point for a reconstruction of the taxpayer's financial history by the net worth method.

[6] Cf. *People's Deposit Bank & Trust Co., Paris, Ky. v. United States*, 212 F.2d 86 (6 Cir. 1954), *cert. denied* 348 U.S. 838 (1954), holding the Special Agent's testimony that he concludes there is a strong suspicion of a false or fraudulent return to be sufficient. The agent is not required to disclose the facts relative to his investigation and conclusion nor is the District Court obliged to require proof of facts showing reasonable grounds to believe the tax returns were false and fraudulent.

[7] The court recognized in its opinion at p. 370 that this ruling was in conflict with those of the Second and Fifth Circuits.

*United Distillers Products Corp.*, 156 F. 2d 872, 874 (2 Cir. 1946).[8]

The courts which have held that it is necessary for the Government to show "probable cause" to suspect fraud have never dealt with the precise aspect of the question raised by the instant case. It is the theory of the petitioner that the court in passing on the existence of "probable cause" to suspect the taxpayer of fraud in statute barred years must make its own determination of the existence of "probable cause" on the basis of the facts believed by the court. (See *Henry* v. *United States*, 80 S. Ct. 168 (1959)). The Court of Appeals accepted the ruling of the District Court that the court will accept as true the Government witnesses' statements as to the underlying facts, unless the taxpayer can show that they are "so incredible that no reasonable man can believe them." (p. 22, *infra*). This is an erroneous ruling which makes the court a mere rubber stamp and in effect gives Government officials the right to make orders of contempt. This decision will enable the Government to nullify the effect of the three year statute of limitations and to deprive the taxpayers of this vital protection.

The restriction on the courts to determine the credibility of a witness — even though the determination of "probable cause" is a preliminary matter — gives to an

[8] The conflict between the District Court decisions both before and after this ruling is an excellent example of the confusion as to the correct test. They have held that the Government must set forth the facts which lead it to believe fraud may exist, *In re Brooklyn Pawnbrokers, Inc.*, 39 F. Supp. 304 (E.D. N.Y. 1941), that merely a conclusory allegation of a false and fraudulent return is sufficient, *Application of Carroll*, 149 F. Supp. 634 (S.D. N.Y. 1957), and that the examination sought must be shown to be necessary, relevant and material, *In re Foster*, 159 F. Supp. 444 (S.D. N.Y. 1958). The issue was discussed but not decided by the Circuit Court in *United States* v. *Carroll*, 246 F.2d 762 (2 Cir. 1957), *affirming Application of Carroll*, supra, on other grounds. In its opinion the court reviews some of the conflicting decisions.

administrative official a tremendous bureaucratic weapon buttressed by the force of the state which may and frequently does cause irreparable harm to the individual. A fraud investigation conducted by Special Agents of the Internal Revenue Service is usually a lengthy, detailed one in which countless individuals with whom the taxpayer did business are contacted. Even though no action results from such an investigation the rumors and innuendo remain. It can and has ruined innocent business men, for no one wants to do business with a person or firm undergoing investigation for tax fraud.

The law dealing with tax fraud investigations is conflicting and confused throughout the entire United States and should be clarified by this Court for the guidance of the taxing authorities and for the protection of the taxpayer.

## Conclusion

For the foregoing reasons this petition for a writ of certiorari should be granted.

Respectfully submitted,

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*Of Counsel:*
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## Appendix A

Section 6501. Limitations on Assessment and Collection:

(a) General Rule. Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

(c) Exceptions.

(1) False Return. In the case of a false or fraudulent return with the intent to evade tax, the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

(2) Willful Attempt to Evade Tax. In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

Section 7602. Examination of Books and Witnesses:

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting

any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

Section 7604. ENFORCEMENT OF SUMMONS:

(b) ENFORCEMENT. Whenever any person summoned under section 6420(e)(2), 6421(f)(2), or 7602 neglects or refuses to obey such summons, or to produce books, papers, records, or other data, or to give testimony, as required, the Secretary or his delegate may apply to the judge of the district court or to a United States commissioner for the district within which the person so summoned resides or is found for an attachment against him as for a contempt. It shall be the duty of the judge or commissioner to hear the application, and, if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought

before him to proceed to a hearing of the case; and upon such hearing the judge or the United States commissioner shall have power to make such order as he shall deem proper, not inconsistent with the law for the punishment of contempts, to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

Section 7605. TIME AND PLACE OF EXAMINATION:

(b) RESTRICTIONS ON EXAMINATION OF TAXPAYER. No taxpaper shall be subjected to unnecessary examination or investigations, and only one inspection of a taxpayer's books of account shall be made for each taxable year, unless the taxpayer requests otherwise or unless the Secretary or his delegate, after investigation, notifies the taxpayer in writing that an additional inspection is necessary.

Appendix B

# United States Court of Appeals

## For the First Circuit

No. 5537.

DAVID LASH,
TREASURER, DAVID'S, INC.,
RESPONDENT, APPELLANT,

*v.*

LAURENCE A. NIGHOSIAN,
REVENUE AGENT, INTERNAL REVENUE SERVICE,
PETITIONER, APPELLEE.

APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS.

Before WOODBURY, *Chief Judge*, HARTIGAN, *Circuit Judge* and SWEENEY, *District Judge*.

*Jacob Spiegel*, with whom *Zipporah B. Wiseman* was on brief, for appellant.

*Rita E. Hauser*, Attorney, Department of Justice, with whom *Charles K. Rice*, Assistant Attorney General, *Lee A. Jackson* and *A. F. Prescott*, Attorneys, Department of Justice, *Anthony Julian*, United States Attorney, and *Charles F. Barrett*, Assistant U. S. Attorney, were on brief, for appellee.

### OPINION OF THE COURT.

December 4, 1959.

WOODBURY, *Chief Judge*. This is an appeal from an order of the United States District Court for the District of Massachusetts directing the respondent, as the treasurer of David's Inc., to appear with specified corporate records before a revenue agent of the Internal Revenue Service at

a given time and place to testify as to the tax liability of David's, Inc., for the years 1952 to 1955, inclusive.[1]

David's, Inc., to be referred to as the taxpayer hereinafter, is engaged in the loan business in Fall River, Massachusetts. Its returns for the fiscal years 1952 and 1953 were examined by one revenue agent and its returns for the fiscal years 1954 and 1955 were examined by another. These agents duly submitted their audit reports in September, 1954, and July, 1956, respectively.

Subsequent to these examinations the Regional Inspector, who operates independently of the Regional Commissioner and reports directly to headquarters in Washington, and who is concerned with the operating practices and the security and integrity of the Internal Revenue Service in his Region, and the Regional Commissioner, who is concerned primarily with the determination and collection of taxes in his Region, set up a joint project to investigate allegations of collusion between taxpayers and revenue agents in the Fall River area. Field agents working on this joint project reported to the project coordinator that their investigations disclosed close personal and business relationships between the respondent and the agents who had examined the taxpayer's returns for the years involved. They reported that prior, during and subsequent to his audit the agent who had examined the taxpayer's returns for 1952 and 1953 had negotiated for himself and members of his immediate family several loans from the taxpayer amounting in gross to $11,000 and that these loans were unsecured, bore either no interest or interest at one half of one per cent per month, and that the taxpayer's cards recording the loans were marked DND for "do not

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[1] In *O'Connor* v. *O'Connell*, 253 F.2d 365 (C.A. 1, 1958), this court held that orders such as this were "final decisions" and hence appealable under Title 28 U.S.C. § 1291.

dun."[2] And they reported that the respondent had a long-standing personal relationship with the agent who had examined the taxpayer's returns for 1954 and 1955, that the respondent had negotiated an exchange of checks in the amount of $6,500 for the agent's minor son, that the respondent had served as an accommodation party in a real estate transaction entered into on behalf of members of the agent's family pending the outcome of a law suit and that he had also served as an officer of the agent's family corporation. They also reported that in an interview the respondent had said that he made loans to revenue agents at favorable rates, that he encouraged good relations with revenue agents, and that he had frequent social meetings with revenue agents, such as meeting with them for drinks at cafes two or three times a week.

The coordinator of the joint project passed this information on to the Regional Commissioner with the request for a reopening letter addressed to the taxpayer and the Commissioner complied on May 20, 1958. The respondent declined to make the taxpayer's books and records for the years 1952 through 1955 available for inspection as requested in the reopening letter and on June 13 he was served with a summons issued by the Commissioner under § 7602 of the Internal Revenue Code of 1954. 26 U.S.C. § 7602. The respondent appeared at the time and place designated in the summons with some corporate records but refused to permit any inspection of them. Application under § 7604 *id.* for attachment against the respondent as for a contempt was thereupon made to the court below and that court after hearing entered the order enforcing the summons from which this appeal has been taken.

[2] The court below found by inspection of the cards that actually only two of them were so marked.

The first three of the four tax years here involved admittedly are "closed" by the three year statute of limitations (§ 6501 of the Internal Revenue Code of 1954), to the assessment of any tax except for fraud or other matters not involved herein. The basic questions on this appeal are whether the Commissioner as the Secretary's delegate had statutory authority to issue his summons requiring disclosure as to those closed years, and, if he did, whether there was enough evidence before the District Court to warrant its conclusion that there was "probable cause" to believe that the taxpayer's returns for the "closed" years were fraudulent. See *O'Connor* v. *O'Connell*, supra. We think both questions must be answered in the affirmative.

Counsel for the appellant asserts that all of the evidence points inescapably to the conclusion that the sole purpose of the Regional Commissioner in issuing the summons directed to the taxpayer was to further the investigation of the Inspection Service into the conduct of the revenue agents who had audited the taxpayer's returns for the closed years in question. Wherefore he contends that the Commissioner as the Secretary's delegate lacked statutory authority to issue the summons, for § 7602, *supra*, gives the Secretary or his delegates power to summon a person liable for tax only "For the purpose of ascertaining the correctness of any return."

The District Court found that "the Regional Inspector could be said to have instigated the reopening letter," and that "the Inspection Service hopes that its investigation may benefit from the present proceeding." But it found that the investigation of the conduct of the revenue agents was not the Commissioner's sole purpose for issuing the summons. And it found that this case was not one in which no discoverable incorrectness in the taxpayer's returns for the closed years could lead to the determination of a

tax liability. On the basis of these findings it, we think entirely correctly, distinguished *United States* v. *O'Connor*, 118 F. Supp. 248 (D.C. Mass., 1953). See *Boren* v. *Tucker*, 239 F.2d 767, 772, 773 (C.A. 9, 1957). The court then found and ruled as follows:

> "The very circumstances which excited the interest of the Regional Inspector here were of equal concern to the Regional Commissioner. If examination of the corporate books and records were to disclose malfeasance on the part of the agents who examined the returns, by the same token it might well disclose irregularties by the taxpayer. While the interest of the Inspection Service was primary in point of time, and continued, I find the summons was issued in the name of a revenue agent attached to the Audit Division as a result of a reopening letter signed by a Regional Commissioner whose purposes included a bona fide desire to ascertain the correctness of David's returns in connection with David's tax liability. I rule that neither the additional, concurrent interest of the Regional inspector for other purposes, nor the fact that he was the first actor in the matter, is a legal deterrent to these proceedings."

The findings of fact above are supported by substantial evidence in the record and the reasonable and logical inferences to be drawn from that evidence. Thus under the familiar principle embodied in Rule 52(a) F.R.C.P. they cannot be successfully challenged in this court. And we agree with the District Court's rulings on that evidence.

Under § 7602 of the Internal Revenue Code of 1954 the authority of the Secretary or his delegate to summon persons liable for tax is limited to "the purpose of ascertaining the correctness of any return." The authority is not,

although of course it might have been, further limited by requiring that the "sole" or "primary" purpose of the Secretary or his delegate in issuing a summons must be to determine whether a taxpayer has filed a correct return. However, were we to read into the section greater limitations upon the power to summon than the Congress chose to provide, we believe that we would not be construing the section but legislating. As the statute reads there is authority to summon for the purpose of ascertaining the correctness of a taxpayer's return. There must be this purpose. That there may perhaps also be other purposes in particular cases seems to us inconsequential as it did to the court below. See *Boren* v. *Tucker*, supra.

We turn now to the question whether there is sufficient evidence in the record to support the District Court's order directing compliance with the summons served upon the respondent-appellant.

In *O'Connor* v. *O'Connell*, 253 F.2d 365, 370 (C.A. 1, 1958), we rejected the contention that all the Secretary or his delegate needed to show to obtain an order enforcing a summons with respect to a closed year was the honesty of his subjective belief that the taxpayer had been guilty of fraud in such a year. We said that to make the provision of § 7605(b) of the Internal Revenue Code of 1954 forbidding unnecessary examinations or investigations of a taxpayer's books of account truly effective "the Secretary or his delegate, when a court order is needed to enforce compliance with a summons to testify as to a 'closed' year, should be required to establish to the court's satisfaction that there is probable cause for an investigation into such a year." We pointed out that this did not mean that proof of fraud was required but meant only "that before the tax authorities are entitled to a district court order enforcing a summons directing a taxpayer to testify as to a closed year they must establish to the district

court's satisfaction that a reasonable basis exists for a suspicion of fraud, or put another way, that there is probable cause to believe that the taxpayer was guilty of fraud in a statute barred year."

The District Court encountered difficulty in applying the rule of *O'Connor* v. *O'Connell*, its particular difficulty being with the nature and extent of the burden resting on the petitioner to show probable cause or reasonable ground for suspicion of the existence of fraud. It posed the question: "Is the district court to be satisfied that a reasonable basis exists for petitioner's determination, as to both the underlying facts and the existence of probable cause, or is it to make its own?"

In *O'Connor* v. *O'Connell* we used the substantially synonymous phrases, see footnote 3 *Draper* v. *United States*, 358 U.S. 307, 310 (1959), "probable cause" and "reasonable grounds" in their generally accepted meaning in other contexts. In using the familiar phrases we meant to imply that in ordering enforcement of a summons the district court should apply the same test that it would apply in deciding whether an arrest by an officer without a warrant, and perhaps his incidental search of the person of his prisoner, complied with constitutional or statutory requirements. See *Draper* v. *United States*, supra, and *Brinegar* v. *United States*, 338 U.S. 160 (1949), and cases cited. See particularly *Carroll* v. *United States*, 267 U.S. 132, 161 (1925), in which Mr. Chief Justice Taft writing for the Court said quoting and citing earlier cases: "'If the facts and circumstances before the officer are such as to warrant a man of prudence and caution in believing that the offense has been committed, it is sufficient.'" The function of the district courts in these cases as we see it is comparable to the function of a grand jury. It is to prevent the Secretary or his delegate from going on a "fishing expedition" into a taxpayer's books or

records for closed years, or from acting upon a mere hunch or a vague surmise, but to permit inspection as to closed years when the court is satisfied, meaning persuaded or content, that the official who issued the summons had a reasonable basis for his belief that the taxpayer had been guilty of fraud in a closed year. Thus we think the court below was quite right when it said during the trial, and repeated in its opinion, that if a basis for probable cause was shown by witnesses whose testimony, although contradicted, was not so incredible as to be beyond reasonable belief, it would not substitute itself for the Regional Commissioner in resolving the issue of fact presented.

We see no need for lengthy discussion of the question of the sufficiency of the evidence to warrant the District Court's order of enforcement. Certainly an ulterior tax motive leading to a reasonable suspicion of fraud may be inferred from the evidence of the respondent's business and personal intimacy with the agents who audited the taxpayer's returns.

Other arguments advanced by the respondent-appellant do not require discussion.

*Judgment will be entered affirming the order of the District Court.*

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No. 641

# In the Supreme Court of the United States

OCTOBER TERM, 1959

DAVID LASH, TREASURER, DAVID'S, INC., PETITIONER

*v.*

LAURENCE A. NIGROSIAN, REVENUE AGENT, INTERNAL REVENUE SERVICE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIRST CIRCUIT*

## BRIEF FOR THE RESPONDENT IN OPPOSITION

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## BRIEF FOR THE RESPONDENT IN OPPOSITION

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### OPINIONS BELOW

The opinion of the district court (R. 287–293) is reported at 171 F. Supp. 121. The opinion of the court of appeals (Pet. 15–22) is not yet reported.

### JURISDICTION

The judgment of the court of appeals was entered on December 4, 1959 (Pet. 15). The petition for a writ of certiorari was filed on January 14, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

### QUESTIONS PRESENTED

1. Whether a summons issued under Section 7602 of the 1954 Code, for the statutory purpose of ascertaining the correctness of certain returns filed by the taxpayer corporation, is invalid because a concomitant

purpose of the investigation was the discovery of irregularities on the part of the revenue agents who had previously examined and reported upon the returns.

2. Whether there was sufficient evidence presented at the enforcement hearing to support the district court's conclusion that there was probable cause for suspecting that the returns filed for the years 1952 through 1954 were fraudulent.

## STATUTES INVOLVED

Internal Revenue Code of 1954:

> SEC. 6501.[1] LIMITATIONS ON ASSESSMENT AND COLLECTION.
>
> (a) [as amended by Sec. 165(a), Act of September 2, 1958, 72 Stat. 1313] *General Rule.*—Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.
>
> * * * * *
>
> (c) *Exceptions.*—
>
> (1) *False return.*—In the case of a false or fraudulent return with the intent to evade tax,

[1] Sections 275(a) and 276(a) of the Internal Revenue Code of 1939 (26 U.S.C. 1952 ed., Secs. 275(a) and 276(a)) contain substantially similar provisions.

the tax may be assessed, or a proceeding in court for collection of such tax may be begun without assessment, at any time.

(2) *Willful attempt to evade tax.*—In case of a willful attempt in any manner to defeat or evade tax imposed by this title (other than tax imposed by subtitle A or B), the tax may be assessed, or a proceeding in court for the collection of such tax may be begun without assessment, at any time.

* * * * *

(26 U.S.C. 1958 ed., Sec. 6501)

SEC. 7602. EXAMINATION OF BOOKS AND WITNESSES.

For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary or his delegate may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and

to give such testimony, under oath, as may be relevant or material to such inquiry; and

(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry.

(26 U.S.C. 1958 ed., Sec. 7602)

SEC. 7604. ENFORCEMENT OF SUMMONS.

* * * * *

(b) [as amended by Sec. 4(i), Act of April 2, 1956, c. 160, 466, 70 Stat. 87, and Sec. 208(d)(4), Highway Revenue Act of 1956, c. 462, 70 Stat. 374, 387] *Enforcement.*—Whenever any person summoned under section 6420(e)(2), 6421(f)(2), or 7602 neglects or refuses to obey such summons, or to produce books, papers, records, or other data, or to give testimony, as required, the Secretary or his delegate may apply to the judge of the district court or to a United States commissioner for the district within which the person so summoned resides or is found for an attachment against him as for a contempt. It shall be the duty of the judge or commissioner to hear the application, and, if satisfactory proof is made, to issue an attachment, directed to some proper officer, for the arrest of such person, and upon his being brought before him to proceed to a hearing of the case; and upon such hearing the judge or the United States commissioner, shall have power to make such order as he shall deem proper, not inconsistent with the law for the punishment of contempts, to enforce obedience to the requirements of the summons and to punish such person for his default or disobedience.

* * * * *

(26 U.S.C. 1958 ed., Sec. 7604)

## STATEMENT

This case involves the enforcement, under Section 7604 of the Internal Revenue Code of 1954, of an internal revenue summons requiring petitioner, the treasurer of the taxpayer (a corporation engaged in the loan business), to testify and to produce certain records germane to the corporation's tax liabilities for the fiscal years 1952 to 1955 (R. 4–5, 15, 291). The corporation's returns for the fiscal years 1952 and 1953 were examined by one revenue agent; its returns for the fiscal years 1954 and 1955 were examined by another. The agents submitted their audit reports in September 1954 and July 1956, respectively (R. 71, 74).

Subsequent to these examinations, the Regional Inspector (concerned with the operating practices and the security and integrity of the Internal Revenue Service in his area, and operating independently of the Regional Commissioner) and the Regional Commissioner (concerned primarily with the determination and collection of taxes in his area) undertook a joint investigation into alleged collusion between taxpayers and revenue agents in the area of Fall River, Massachusetts (R. 287–288). That investigation disclosed close personal and business relationships between petitioner and the agents who had examined the taxpayer-corporation's returns for the years involved. More particularly, prior, during, and subsequent to his audit, the agent who had examined the taxpayer's returns for 1952 and 1953 had negotiated for himself and members of his immediate family several unsecured loans from the taxpayer amounting to $11,000,

bearing no interest or interest at one-half of one per cent per month, and some of the taxpayer's cards recording the loans were marked "DND," standing for "do not dun" (R. 71–73, 291). It was further disclosed that petitioner had a long-standing personal relationship with the agent who had examined the taxpayer's returns for 1954 and 1955, that petitioner had negotiated an exchange of checks in the amount of $6,500 for the agent's minor son, that he had served as an accommodation party in a real estate transaction entered into on behalf of members of the agent's family pending the outcome of a lawsuit, and that he had served as an officer of the agent's family corporation. Petitioner admitted during the investigation that he had made loans to the revenue agents at favorable rates, that he had encouraged good relations with them, and that he had had frequent social meetings with them, including drinks at cafes two or three times a week (R. 74–75, 291–292).

On the basis of the disclosures resulting from the joint investigation, the Regional Commissioner notified the taxpayer-corporation on May 20, 1958, that an additional inspection of its books for the years 1952 to 1955, inclusive, was necessary (R. 254). Shortly thereafter, a summons was issued under Section 7602 of the 1954 Code, *supra*, pp. 3–4, to produce certain books and records (R. 4–5), but petitioner refused to obey it (R. 6).

The Internal Revenue Service petitioned the District Court for the District of Massachusetts for an order under Section 7604 of the 1954 Code, *supra*, p. 4, compelling petitioner to comply with the summons.

After a hearing, the district court issued an order enforcing the summons (R. 293–294). The district court first found that the summons was issued not only in the interest of the Inspection Service to disclose the misfeasance on the part of the agents who examined the returns, but also as a result of a bona fide desire of the Regional Commissioner to ascertain taxpayer's tax liability (R. 288–289). Second, the district court held that, although three of the four tax years here involved were closed by the three-year statute of limitations to the assessment of any tax except for fraud (Section 6501 of the 1954 Code, *supra*, pp. 2–3), "serious improprieties" were reasonably suggested by a "situation where a taxpayer unduly cultivates agents, and agents find the advantages such to warrant deliberate infractions of instructions * * *"[2] (R. 289, 293). Therefore, the court concluded that the Commissioner's suspicions of fraud were "reasonable, and that he has shown probable cause to require the respondent to obey the summons with respect to the closed years." (R. 293).

[2] More specifically, the court found that, under the applicable regulations, the agents who had examined the taxpayer's returns should have recused themselves because of the extent of their relationship with the taxpayer, and that, by their willingness to work on the taxpayer's returns, the agents had risked disciplinary action or dismissal from the Service (R. 292–293). See United States Treasury Department, Internal Revenue Service Manual, Audit and Investigation Section, Part IV, Sec. 4031(3) (indebtedness to taxpayer, or business or social relationships); United States Treasury Department, Rules of Conduct for Employees of the Internal Revenue Service, Secs. 29, 35 (business and financial transactions, and receipt of favors).

Petitioner appealed from the order of the district court enforcing the summons, and the court of appeals affirmed (Pet. 15–22).

## ARGUMENT

1. There is no merit in petitioner's contention (Pet. 7–8) that the summons issued in this case was invalid because used "for a purpose other than that set forth in the statute." Section 7602 of the Internal Revenue Code of 1954, *supra*, pp. 3–4, authorizes use of the summons power for the broad and unrestricted "purpose of ascertaining the correctness of any return" filed. The district court found (and the court of appeals concurred (Pet. 19)) that the Commissioner's purpose in forwarding the so-called reopening letter and in issuing the summons in question "included a bona fide desire to ascertain the correctness of [taxpayer's] returns in connection with [taxpayer's] tax liability" (R. 288–289). The statutory purpose was thus fulfilled.

Petitioner suggests that Section 7602 should be read as requiring that the "purpose of ascertaining the correctness of any return" be the sole or primary one. The statute, however, makes no such requirement. *Boren* v. *Tucker*, 239 F. 2d 767, 772–773, (C.A. 9); cf. *Brody* v. *United States*, 243 F. 2d 378, 384 (C.A. 1), certiorari denied, 354 U.S. 923. In any event, the record does not support petitioner's claim (Pet. 2) that "the real purpose" in issuing the summons was "to investigate the conduct of" the agents, and that the purpose of ascertaining the correctness of the returns was merely "subsidiary." The district court found, to the

contrary, that, although the Regional Inspector initiated the investigation, the two purposes existed concurrently: "[t]he very circumstances which excited the interest of the Regional Inspector here were of equal concern to the Regional Commissioner" (R. 288). And the court of appeals, in agreeing, concluded that the concomitance of the two purposes was "inconsequential" (Pet. 20).

2. Contrary to petitioner's contention (Pet. 8–11), the evidence adduced at the enforcement hearing (*supra*, pp. 5–6; R. 71–76, 81–88, 148–160, 191–207) amply supported the conclusion of both courts below (R. 293; Pet. 22) that there was a reasonable basis for suspecting fraud. The court of appeals succinctly characterized that evidence as follows: "Certainly an ulterior tax motive leading to a reasonable suspicion of fraud may be inferred from the evidence of the respondent's business and personal intimacy with the agents who audited the taxpayer's returns" (Pet. 22).

Petitioner claims (Pet. 8–10) that conflicting criteria are used by different Circuits for enforcement of a summons issued under Section 7602 and that here the district court acted as "a mere rubber stamp"

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[3] The court of appeals, like the district court, used "probable cause," on the one hand, and "reasonable grounds" or "reasonable suspicion," on the other, interchangeably. Thus, the court of appeals stated that the phrases were "substantially synonymous" and that the proper test was the same as would be applied "in deciding whether an arrest by an officer without a warrant * * * complied with constitutional or statutory requirements" (Pet. 21). See also *O'Connor* v. *O'Connell*, 255 F. 2d 365, 370 (C.A. 1).

(Pet. 10) for the views of Government officials. But there can be no doubt in the instant case that the evidence satisfied *both* the Commissioner and the district court that there was probable cause for suspecting fraud (R. 293; Pet. 20–22). Similarly, the court of appeals, adhering to its earlier decision in *O'Connor* v. *O'Connell*, 253 F. 2d 365, 370 (C.A. 1), also required that the Government show probable cause—the stricter of the standards which petitioner contends (Pet. 8–10) have been applied by the various Circuits. Since both of the courts below thoroughly considered the evidence in applying the stricter standard, petitioner's discussion concerning the alleged conflicting criteria for enforcement of a summons is, at best, of merely academic interest in this case.

## CONCLUSION

The judgment below is correct, no conflict of decisions is presented, and there is no warrant for further review of this case by this Court.

Respectfully submitted.

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